STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

CENTRAL ILLINOIS LIGHT COMPANY	)	
D/B/A Ameren/CILCO	)	
	)	**No. 05-0160**
Proposal to implement a competitive procurement	)	
Process by establishing Rider BGS, Rider BGS-L,	)	
Rider RTP, Rider RTP-L, Rider D, and Rider MV	)	
	)	
CENTRAL ILLIONOIS PUBLIC SERVICE COMPANY	)	
d/b/a AmerenCIPS	)	
	)	**No. 05-0161**
Proposal to implement a competitive procurement	)	
Process by establishing Rider BGS, Rider BGS-L,	)	
Rider RTP, Rider RTP-L, Rider D, and Rider MV	)	
	)	
ILLINOIS POWER COMPANY	)	
d/b/a AmerenIP	)	
	)	**No. 05-0162**
Proposal to implement a competitive procurement	)	
Process by establishing Rider BGS, Rider BGS-L,	)	
Rider RTP, Rider RTP-L, Rider D, and Rider MV	)	

CITIZENS UTILTY BOARD'S BRIEF IN SUPPORT OF ITS PROPSED EXCEPTIONS

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The Citizens Utility Board ("CUB"), on behalf of Ameren's residential customers in Illinois, submits this brief in support of its Exceptions (Exhibit "A") to the ALJ's proposed order in this matter.

PRELIMINARY STATEMENT

Ameren[1] has literally devoted hundreds of pages to "educate" us about the Rate Relief Law of 1997 and the changes it has made over the last ten years because of it. Ameren continually harps on the fact that its utilities have divested themselves of their generation of electricity. This divesture is merely a legal fiction, of course, because most of this generation was given to an affiliate that has been very profitable for Ameren. One thing has not changed, however. Residential customers have no other utilities from which to purchase electricity except from Ameren. (Their service has not been declared competitive.) Consequently, Ameren is required to provide electricity to these customers under its traditional obligations.

Ameren's most important obligations under the Public Utilities Act are to procure power for the least costs and to charge "just and reasonable rates". "Every unjust or unreasonable charge made, demanded or received for such product or commodity or service is … prohibited and … unlawful." 220 ILCS 5/9-101. The Commission traditionally assures that rates are just by performing after-the-fact, comprehensive prudence reviews of the utilities' conduct in acquiring the power.

The critical issue in this case is that the Commission does not abandon its legal responsibility to perform such a review. This abandonment would not only be unlawful, but also, a bad business decision by the Commission. Absent an after-the-fact prudence

[1] Ameren is the parent company of CIPS, CILCO and IP, the party utilities here. For the sake of simplicity the utilities will be collectively called "Ameren" unless otherwise stated.

review, Ameren would not have any economic incentive to obtain electricity on a least cost basis or prudently. This is especially true under its proposal because every dollar it spends to acquire the power is passed through directly to its customers.

Ameren could run an auction tomorrow without any Commission approval at all. (In fact, as demonstrated below, the Commission cannot pre-approve the auctions since it has no jurisdiction to do so.) Ameren could procure power through a New Jersey-like process and if the rate- freeze lifts as planned in 2007, Ameren could come in for a rate case at the Commission to recover its costs. The only difference is that these costs would be subject to a prudence review.

In a prudence review, the question is, did a utility do a reasonable job at buying power? Did it do the best job it could in keeping rates low? That's what utilities are required to do under the law. To assure that these legal obligations are met, an intensive legal proceeding is conducted at the Commission. Discovery is exchanged, financial transactions are analyzed, alternatives are examined, and a trial is led by an ALJ. Ultimately, the Commission reaches a decision based on a comprehensive examination of an extensive record of after the fact buying actions by the utility

What Ameren wants to do, though, is eliminate this state oversight. It wants to replace a prudence review with a reverse auction, where the Commission would literally have only 72 hours to "consent" to a rate without the ability to consider alternatives or the underlying market.

A concrete example why this is unacceptable can be found in the gas industry. Gas utilities purchase natural gas in the competitive market and sell the product back to customers at cost. At the end of the year, the Commission conducts a prudence review to

determine whether the utility did a reasonable job at keeping customer rates low.

Many times the Commission ultimately determines that a utility did do a reasonable job procuring gas. However, if the Commission identifies problems with the utility's gas purchasing practices, it can order a refund to consumers.

There are many instances where imprudence could only have been discovered through extensive proceedings that examined after the fact conduct. The Peoples Gas fuel reconciliation case, Docket No. 01-0519 is a good example of this. The ALJ concluded that the company engaged in an imprudent contract with Enron that raised gas costs to consumers during the winter of 2000-2001. The proposed order in the case recommends a $119 million refund for consumers. These overcharges would never have been uncovered if the Commission process to examine the company's procurement process was only 72 hours. Without a meaningful review, the Peoples/Enron deal would never have been discovered.

Ameren's reverse auction proposal is bad public policy because it eliminates important state oversight necessary to ensure that consumers' rates are just and reasonable as required by law. It also reflects a reckless incentive structure, and that's the second reason Ameren's proposal is bad from a policy point of view.

Under its plan, Ameren would have no economic incentive to care about the prices customers pay. In fact, because Ameren owns the utilities here, the utilities would actually have the opposite incentive to increase customer rates, as every additional dollar in the bills adds another dollar to the Ameren Corp bottom line. And while Ameren complains that it has been subjected to a rate freeze for the last nine years, Ameren and its affiliates have faired extremely well with rates capped. In 2004, Ameren netted profits

of $530 million. Ameren Corp. Form 10-K Filing for period ending 12/31/04, p. 34. In 2004, CIPS.CILCO and IP had net incomes of $29 million, $10 million and $27 million respectively. Id. In 2004, Ameren's generation affiliate, Genco, netted $107 million despite the fact that it has been selling power to the utilities at supposedly discounted rates. Id

As further demonstrated below, given the serious public policy issues Ameren's plan raises, along with the numerous legal defects from which the auction process suffers, the Commission has no choice but to reject the Ameren plan.

I. INTRODUCTION--THE ALJ'S PROPOSED ORDER AND CUB'S SUMMARY OF THE REASONS FOR ITS PROFFERED EXCEPTIONS

The ALJ has approved Ameren's tariffs, and thus the auction, with some modifications. CUB opposes the approval in its entirety because the Commission lacks the jurisdiction to act on Ameren's proposals. (See Section II., pp. 8-15 below and Ex. A pp.1-5) A review of the proposed tariffs shows that the Commission has no rates or actual conduct to review; the proposals merely provide Ameren a prospective right to set rates into the future. The Commission cannot approve proposed tariffs that contain no actual rates or charges and that grant a utility the prospective right to establish rates in the future. *Citizens Utility Board v. The Illinois Commerce Commission, 275* Ill. App. 3d 329, 655 N.E.2d 961 (1st Dist. 1995)

Even assuming *arguendo* that the Commission does have the jurisdiction to act, it still should deny the tariffs in their entirety. (See Sections IV. & V. pp. 15-31 below and Ex A pp.11-19) The tariffs themselves and the underlying wholesale markets are fatally

flawed in many respects. Id.

Among other things, Ameren's proposals are designed to protect it and enrich its parent company and generating affiliates, at the expense of customers. The record shows that Ameren's goal in proposing the auction is to eliminate all regulated risks for itself rather than procuring power at the lowest possible prices. Under its proposals, every dollar it spends to acquire electricity is entirely passed through to its customers.

Ameren proposes that it not be subject to any after-the-fact prudence reviews to avoid any risk of having those costs deemed imprudently incurred, thereby eliminating the possibility of not passing on all of its costs to customers. Thus, Ameren has designed a procurement process that shifts all of the risks of its potential imprudent conduct to residential customers. This, in turn, could cause customers to be charged unjust and unreasonable rates, which are unlawful. "Every unjust or unreasonable charge made, demanded or received for such product or commodity or service is … prohibited and … unlawful." 220 ILCS 5/9-101. The Commission cannot disregard their obligation to assure the charging of just rates and to leave consumers unprotected.

In addition, Ameren has designed a procurement process that seems to assure its generating affiliates, a high price for its low-cost, high-margin electricity production. Baxter Dir. test. pp. 5 & Sept. 14 test. pp 404-410; Nelson Dir. test. pp. 39-47. Why would Ameren do this when it owes a duty to customers to get the best price possible for them, rather than the highest price possible for its generating affiliates? It is because Ameren employees have stock in its parent company. This stock becomes more valuable as its generating affiliates profits grow. Nelson Sept. 13 test. pp. 118-120. And Ameren is fully aware that its generating affiliates will be direct bidder and that they are well-

positioned vis-à-vis higher-cost, lower-margin generators to profit substantially in the auction. Id. and Nelson Dir. test. pp. 39-47; Baxter Sept. 14 test. pp. 404-410. This situation is yet another reason why the proposals should not be approved and the Commission should not abandon after-the-fact reviews.

Finally, Ameren admits that a competitive, robust wholesale electricity market must exist to assure that the auction will result in the lowest acquisition prices. However, Ameren has failed to meet its burden of showing that such markets are sufficiently developed and competitive to assure such results. There are significant shortcomings presently in these wholesale markets that create many price uncertainties. These uncertainties will have the effect of driving auction-bidding prices up.

In the alternative, if the Commission does decide to approve the auction, CUB agrees with the ALJ's ruling on the annual prudence review with one modification. The presumption of prudence should be eliminated. (See Proposed Modifications pp. 26-31 below; Exhibit A pp 6-10) CUB also agrees that the Commission is not federally preempted from reviewing whether the auction clearing prices are prudently incurred and therefore can eliminate those imprudently incurred costs in rates, as the ALJ has ruled. (See Proposed Modifications pp. 29-31 below; Exhibit A pp. 6-10) Finally, CUB requests Exceptions to include a state monitor and consumer advisor and to account for migration risks. (See Proposed Modifications pp. 29-33 below; Exhibit A pp. 20-21)[2]

II. LEGAL ISSUES BARRING THE APPROVALOF THE AUCTION

B. The Commission lacks the authority under the Act to approve the filed tariffs.

The Act, 220 ILCS 5/1-101 et seq., provides for the general supervision of all public

[2] Not every CUB exception is explained in the brief because the reasons for them are self evident or consistent with why CUB believes that the proposal should be disapproved because of alternative procurement methods , insufficient markets and the the proposal's request to eliminate prudence reviews.

utilities by the Commission. The Commission's power and authority come strictly from the Act, and the Commission cannot, by its own actions, extend its jurisdiction beyond the law. *Harrisonville Tel. Co. v. Ill. Commerce Comm'n*, 343 Ill. App. 3d 517, 797 N.E.2d 183 (5th Dist. 2003) *aff'd.* 207 Ill. 2d 601, 807 N.E.2d 974 (2004). Consequently, the Commission can only determine facts and enact orders concerning the matters specified in the Act. Id. For the reasons discussed below, the Act does not confer the Commission with the jurisdiction to approve Ameren's proposals.

At the outset, one issue must be put to rest. Ameren has touted its proposals as the best method of ushering Illinois into a new and supposedly "welcomed" era of market-based prices to its customers. See e.g., McNeil Dir. test. pp. 16-19, 31. According to Ameren, that is one of the primary goals of the Rate Relief Law of 1997, and the time has come to implement it. Market prices, however, cannot be charged here. The condition precedent for the charging of such prices to Ameren's residential customers has not been met. That is because the Commission has not declared tariff services for these customers "competitive", as required under 220 ILCS 5/16-113. [3]

Accordingly, Ameren must acquire and provide electricity to its customers under its traditional obligations. 220 ILCS 15/16-103 ("[a]n electric utility shall continue offering to retail customers each tariffed service that it offered as a distinct and identifiable service

[3] Section 5/16-113 provides in part that "the Commission shall declare the service to be a competitive service for some identifiable customer segment or group of customers, or some clearly defined geographical area within the electric utility's service area, if the service or a reasonably equivalent substitute service is reasonably available to the customer segment or group or in the defined geographical area at a comparable price from one or more providers other than the electric utility or an affiliate of the electric utility, and the electric utility has lost or there is a reasonable likelihood that the electric utility will lose business for the service to the other provider or providers; provided, that the Commission may not declare the provision of electric power and energy to be competitive pursuant to this subsection with respect to (i) any retail customer or group of retail customers that is not eligible pursuant to Section 16-104 to take delivery services provided by the electric utility and (ii) any residential and small commercial retail customers prior to the last date on which such customers are required to pay transition charges."

on the effective date of this amendatory Act of 1997 until the service is … declared competitive pursuant to Section 16-113.") Ameren has a duty to acquire the electricity at its least cost. 220 ILCS § § 5/1-102 & 5/16-103. Ameren also has a duty to conduct itself prudently in acquiring that power. Id; 220 ILCS 5/9-101 & 5/9-201. Then, the Commission has the obligation to scrutinize Ameren's conduct to assure that it in fact acted prudently and acquired the electricity at its least cost. 220 ILCS 5/9-101 & 5/9-201. See also *Pullman Co. v. Illinois Commerce Comm'n*, 390 Ill. 40, 60 N.E.2d 232 (1945).

Under applicable law, if all the costs of acquiring the power are prudently incurred, then those costs can be passed on to customers through rates. Id. But if any cost is deemed imprudent, it cannot be included in rates. Id. The entire process is designed to guarantee customers that they are only charged "just and reasonable" rates. 220 ILCS 5/9-101. Illinois law has made clear that "[e]very unjust or unreasonable charge made, demanded or received for such product or commodity or service is … prohibited and … unlawful." Id

A review of Ameren's proposals in light of the Act and applicable case law shows that the Commission lacks jurisdiction to approve Ameren's proposed tariffs. As is evident from Ameren's initial filings, it has not filed a schedule of actual rates, charges, or executed contracts. Consequently, the Commission has no actual rates, charges or executed contracts to review for reasonableness or justness. Stripped of their technical jargon, Ameren's filings merely propose a descending clock auction procurement process that is replete with enormous non-reviewable discretion to be exercised by Ameren and its auction manager. Then, Ameren asks the Commission, and equally important, its customers, to accept on blind faith that the resulting clearing prices will automatically be

just and reasonable. Indeed, Ameren is proposing that the Commission forgo any meaningful after-the-fact prudence review of the actual, resulting auction prices.

Ameren has fashioned its proposal so that it bears no financial risk. Ameren proposes that the auction prices and all of the enormous costs of running the auction be passed on dollar for dollar to its customers. Thus, even if the resulting prices were imprudently incurred or not the least costs for the power, Ameren nevertheless bears no risk of not recouping all of its costs of paying for the power from its customers.

Under the above circumstances, the Commission lacks jurisdiction to approve Ameren's proposals. The Commission cannot approve proposed tariffs that contain no actual rates or charges and that grant a utility the prospective right to establish rates in the future. *Citizens Utility Board v. The Illinois Commerce Commission, 275* Ill. App. 3d 329, 655 N.E.2d 961 (1st Dist. 1995) The risk of allowing Ameren's auction to be pre-approved is obvious. The customer is exposed to a substantial danger of being charged an unlawful, unjust rate; a rate that unlikely will ever be discovered because of the absence of an after-the-fact prudence review.

The question of whether the Commission has the jurisdiction to pre-approve the open-ended, type of proposals at issue here was answered in the negative in the *Citizens Utility Board* case. In that case, ComEd filed with the Commission a proposed "load retention" tariff designated as Rate CS Contract Service, Ill. C.C. No. 4, Original Sheet No. 55.50. The purpose of the tariff, as with load retention tariffs generally, was to maintain existing "load" by inducing customers to remain with ComEd rather than utilize an alternative source of energy. Under the terms of the tariff, ComEd would achieve load retention by offering discounted rates to a limited number of commercial and industrial users vis-à-vis

negotiated contracts.

As is here too, the actual charges under the proposals were not included in the proposed tariff on file with the Commission. The proposals merely granted ComEd the prospective right to set rates in the future. The tariff itself made clear that "the charges for service hereunder shall be the charges contained in the contract between the Company and the customer." 275 Ill. App. 3d at 333. As here too, executed contracts did not exist at the time ComEd filed its tariff. Without the contracts, there were no rates or charges to be reviewed. The only limitation as to the future rate that could be charged was that "the revenues from the discounted rate could not be less than the incremental cost of providing service to the customer, thereby ensuring a positive contribution to the utility's fixed costs." Id.

The First District held that the proposal violated the Act, and consequently, the Commission did not have the jurisdiction to approve the proposal. Id. at 338-339. The court noted that there were no rates set out in the proposal at the time of ComEd's filing. Id. The proposals, like here, merely set out the parameters under which ComEd could set those rates. Consequently, the Court held that the Commission could not approve a tariff that permitted a utility to establish rates in the future, subject only to the condition that the rates contribute to the utility's fixed costs. Id. Such a condition is implied in every "just and reasonable" rate and, standing alone, does not properly constitute a "rate" under the Act, as further explained by the court. Id. Thus, the Commission has no jurisdiction to approve proposals that grant a utility a prospective right to set rates into the future,

which is precisely what Ameren is proposing here.[4] Id.

Ameren asserts that the Commission can pre-approve a procurement process, citing *The City of Chicago v. Illinois Commerce Commission,* 13 Ill 2d 607, 150 N. E. 2d 776 (1958) as its support. That case does not support Ameren's position.

In *City of Chicago*, the Commission approved Peoples Gas' request for a cost-of-natural gas adjustment clause as part of its existing rate tariffs. The clause provided for periodic automatic adjustment of Peoples' sales price for gas, to reflect changes in the wholesale cost to it of natural gas purchased. In substance, the automatic adjustment clause provided for increases or decreases in the charges for gas sold by Peoples to the extent of increases or decreases in the wholesale price of such gas.

The Supreme Court upheld the Commission's approval noting that the automatic adjustment clause was a set formula by which the price of natural gas to the ultimate consumer was fixed by inserting in the formula the wholesale price of natural gas as established by the FPC. The court also noted that The Natural Gas Act of 1938, (U.S. Code, Title 15, sec. 717 *et seq.*) vested the power to fix rates for natural gas transported and sold to distributing companies in interstate commerce exclusively in the FPC and preempted any right which might have existed in the States to regulate such rates. Thus, Illinois had to charge, and Peoples had to pay, the FPC determined rate, and the Commission had no power over such rate. The court also noted that the City did not contend that the FPC prices were unreasonable and therefore subject to disallowance by the Commission as an operating expense of Peoples. Consequently, the clause was allowed because it was simply an addition of a mathematical formula to the filed

[4] The Act was amended to allow for load retention tariffs and for Ameren to enter into the contracts in issue in the *Citizens* case. The holding in the case is still applicable here, however, and has never been overruled or weakened by any subsequent laws or cases.

schedules of Peoples under which existing rates and charges fluctuated as the wholesale cost of gas to Peoples fluctuated.

The proposals at issue here do not even remotely resemble the adjustment clause in *The City of Chicago* case. This is not a case involving a process that merely and mathematically adjusts existing rate schedules. Indeed, unlike the *City of Chicago* case, where the underlying adjustable rates were not challenged, here there are no underlying rates at all. Instead, at issue here is Ameren's request for pre-approval of an auction process never used or tested in Illinois before for Ameren's retail full requirements electric supply at unknown, unconstrained, uncapped and unspecified rates. (New Jersey is the only state using an auction but with supply products different than Illinois. Ohio ran an auction but never used the auction prices because they were higher than the regulated rates.)

Moreover, after the auction, there is no prudence review by the Commission of those rates or the procurement process itself. Instead, there is a mere three day window period in which the Commission can reject the auction, but only if the auction was not run according to the rules or if there is unambiguous evidence of foul play. Lastly, to arrive at such a "prompt decision" of whether to reject the auction prices, the Commission will primarily rely on the auction manager's report that was prepared merely one day after the auction by a manager hired and paid for by Ameren.

Ameren also cited another case, *The Citizens Utility Board v. The Illinois Commerce Commission*, 166 Ill 2d 111 (1995), to support the notion that its proposal to establish rates can be pre-approved. Ameren's reliance on this case is also erroneous.

The Citizens Utility Board case addressed the ratemaking treatment of expenses

Illinois gas and electric utilities were liable for under existing Federal and State environmental law, particularly CERCLA, *42 U.S.C. § 9601 et seq.* and similar State environmental legislation, *Ill. Rev. Stat. 1991, ch. 111 1/2, par.* 1022.2 *et seq.* The costs at issue were incurred to remediate environmental damage, specifically coal-tar residue found at former manufactured gas plant sites. Following lengthy hearings on the nature and treatment of the expenses, the Commission found that Illinois utilities had prudently operated manufactured gas plants (MGP) plants. The Commission also held that utilities could recover the cost of the statutorily mandated coal-tar cleanup expenses from ratepayers. The Commission ruled that the preferable recovery method was by means of a rate mechanism known as a rider. CUB challenged the ruling in the Illinois Supreme Court.

The Supreme Court never specifically addressed whether the Commission lacked the statutory authority to pre-approve the utilities' ability to recoup coal–tar remediation costs from ratepayers through a rider. The court noted that CUB had not properly raised this argument before the ICC. 166 Ill. 2d at 135-136. The court therefore held that "[b]ecause CUB's petition for rehearing did not argue a lack of statutory authority as grounds for finding the rider illegal, this contention [was] also waived in the present appeal." Id. Accordingly, the above case is of no assistance to Ameren either in arguing the Commission has the authority to pre-approve the proposal.

For the above reasons, the Commission has no jurisdiction to approve Ameren's proposals. Consequently, CUB requests the elimination of all language approving the auction and substituting language that holds that the Commission lacks the jurisdiction to approve the auction. (Ex. A. pp.1-5)

IV. SUFFICIENCY OF THE COMPETITIVE MARKET

Ameren has made certain representations in this proceeding about the wholesale electrical market--that it is well developed and robust, and provides a solid foundation for a successful auction. Ameren must obviously take this position because the auction's "success" depends on the existence of such extensive, healthy markets. These markets are not healthy, however. Instead there are many market flaws and uncertainties that create significant doubt that Ameren will be purchasing electricity on a least cost basis.

Robert M. Fagan, a Senior Associate at Synapse Energy Economics, Inc., testified on direct and rebuttal there are many shortcomings and price-influencing uncertainties within the post-2006-period wholesale market structure in Illinois that will lead to higher bid prices than Ameren is willing to admit.

He testified how the relative immaturity of the MISO spot energy markets and the insufficient scope of capacity and ancillary service structures in MISO result in a high level of uncertainty concerning the competitiveness of the MISO spot energy markets. Fagan Dir. test. pp. 5-11 This affects the ability of potential auction participants to secure competitively priced supplies from the MISO region, in the spot market itself and also in forward bilateral markets, thereby exerting upward pressure on prices in the proposed competitive procurement auction ("CPA"). Id.

An immature MISO spot market will result in greater unpredictability and volatility of prices relative to the prices expected from a more mature market. Id. The pricing outcomes of the proposed CPA will be influenced by participants' perceptions of the maturity of the MISO spot market. Id. Winning auction participants will likely use the MISO spot market for at least some portion of their supply, and will value energy in the

region in part based on expectations of the MISO spot price. Id. Therefore, auction participants are likely to bid at higher prices to the CPA in order to address the financial risk they face in needing to rely at least in part on the MISO spot market for a portion of their supply, if they win at auction. Id. Thus, the CPA clearing prices will reflect these higher price offerings and will clear at prices higher than would be expected after the MISO markets are more mature. Id.

Second, Mr.Fagan testified how the "seam" between MISO and PJM presents a barrier to effective trade between the regions, illustrating that the seam runs directly across Illinois, separating the wholesale electric markets in Northern Illinois from those in Central and Southern Illinois. This denies Central and Southern Illinois residents the benefits of a cohesive, integrated wholesale marketplace for electricity purchase by prospective retail suppliers. Id. at pp. 11-16 Illinois consumers will be impacted by any wholesale market attributes that arise due to the presence of this seam. Id. As shown in his Exhibit 1.2, the seam particularly impacts Illinois, as it slices through the state and leaves approximately two-thirds of the consumers on one side (Northern Illinois) and the remaining third on the other side (Central and Southern Illinois). Thus, two-thirds of the customers will be impacted by wholesale market activity in the western portion of PJM, and one-third of the customers will be impacted by wholesale market activities in central MISO.

The main impact is less efficient energy transactions between the two RTO regions, resulting in greater overall production costs for energy than would be required if a single common market was in place, and likely "distorted" LMPs, or deviations from LMPs that would be expected if a common market were functioning and coordination between

RTOs was comprehensive. Fagan Dir. test. pp. 11-16. While PJM and MISO will likely eventually resolve the technical issues to ensure such coordination, it may well be 2008 or beyond before such resolution is assured. Id.

Mr. Fagan further explained that the presence of two sets of rules and practices for ancillary services and for installed capacity leads to additional inefficiencies in the wholesale market. Id. Absent the seam, installed capacity and ancillary services would be available from both Northern and Central and Southern Illinois to compete in a single wholesale market, likely resulting in lower prices due to greater supply availability and load diversity benefits. The fractured nature of the wholesale market in Illinois leads to missed opportunities for suppliers to provide and loads to access capacity and ancillary services available across the seam.

Third, Mr. Fagan testified why existing market monitoring and mitigation rules in place in MISO and PJM are insufficient to address the potential exercise of wholesale market power in the Illinois region and the resulting increase in prices likely to be seen in the proposed competitive procurement auction. Fagan dir.test. pp 16-19. Both MISO and PJM regions are potential sources of wholesale power for suppliers participating in the CPA. Thus, even though the CPA is for load wholly in the MISO region, the market mitigation construct in both regions will impact CPA suppliers. PJM and MISO each have separate market power mitigation protocols in place. PJM's market power mitigation consists primarily of the ability to "offer price cap" generation suppliers to one of four possible levels when local transmission constraints are binding and an insufficient number of suppliers exist to relieve the constraint. A commonly understood offer-cap level is 110% of the incremental operating cost of the resource; alternatively, the level

could be equal to a weighted LMP, or an agreed-upon level between the owner and PJM. If a resource is considered "frequently mitigated", or offer-capped for more than 80% of its run hours, then the offer cap consists of incremental costs plus the higher of $40/MWh or an agreed-upon amount between the owner and PJM.

The mitigation protocol in MISO is different from that in PJM. Id. MISO imposes offer-price mitigation only if offer price and market impact thresholds are violated. MISO defines two areas: broadly constrained area (BCA) and narrowly-constrained area (NCA) within which its mitigation protocols apply. Within BCAs, if a transmission constraint is binding, MISO will screen offer prices and if they are below the threshold of 300% of the "reference level" offer price (a marginal cost based metric) or $100/MWh, whichever is lower, then no action is taken. Within NCAs, the threshold is lower; it is tied to the cost of a new peaking unit in the area. At present, for market-based price offerings commencing June 1, 2005 in MISO, the NCA threshold above reference level is approximately $37/MWh.

Primarily, such an offer cap results in a greater return to the supplier than would be expected in a fully competitive market. Id. The ten percent adder is somewhat arbitrary and it has not been definitively shown that a lower level would not result in outcomes more closely approximating fully competitive markets. Also, there is currently uncertainty as to whether or not an additional offer capping exemption will be granted for any major constraints in the PJM West region, which consists of the ComEd, AEP, Dayton Power and Light and Allegheny Power areas. This would result in a reduced ability for the PJM market monitor to impose mitigation in the PJM West region when certain transmission constraints are binding. Also, there is uncertainty around the extent

to which PJM can use its "no three pivotal suppliers" test to determine if mitigation can be used when certain transmission constraints bind.

The ability of the MISO market monitor to impose mitigation is even more limited than the authority of the PJM market monitor. In most of the MISO region, there is no mitigation at all unless the offer prices of a generation supplier exceed either 300% of the "reference level" or $100/MWh, whichever is lower. The result is a reduced ability to ensure that market price outcomes are competitive.

Each of the above problems could lead to higher spot or forward market prices, and thus could translate into higher BGS auction pricing. The factors influencing the prices that will result from the proposed auction are indeed relevant, especially if, as Ameren argues, after-the-fact review of auction results is limited. Ameren has not submitted any analysis addressing the likely extent of competitiveness of the MISO spot markets or related forward markets in the 2007-2009 time frame.

In sum, the absence of these "envisioned large successful wholesale markets" and the other market problems identified above cause Ameren to fail in its burden of showing that the auction will ultimately result in just and reasonable rates to customers. Consequently, the proposals should be denied. CUB therefore requests the elimination of all language approving the auction and the substitution of language providing that the Commission should disapprove the auction because of the defects in the market. (Ex. A. pp.10-16)

V. AUCTION DESIGN ISSUES

A. C. & E. General Effectiveness, suitability and auction management.

There are other telling circumstances calling into question Ameren's reasons for

proposing this type of auction besides trying to avoid prudence reviews. The auction is structured to financially benefit Ameren Corporation ("Ameren") and AmerenEnergy Resources ("AER", the generating companies which includes Genco) to the detriment of Ameren customers.

AER is well positioned and expected to significantly profit from the auction. Id. As Warner Baxter, Ameren's executive vice-president and chief financial officer admitted, AER's "plants are amongst the lowest cost generators in the United States." Baxter Sept. 14 test. p. 405. He further admits "the location and low cost of our generation assets positions Ameren very well to compete in the new Illinois market." Id. at 408. He also testified that wholesale electricity prices, particularly in the PJM and MISO markets, are "driven primarily by the cost of natural gas." Id. at 417-419; Rodney Frame Sept. 14 test. pp. 355-356 where he states that the higher cost units set the wholesale prices, which primarily are units fired by natural gas. And natural gas plants have driven wholesale prices up over the years. Many bidders will use these spot prices in formulating bid price ranges. Fagan Dir. test. pp.5-6; See also LaCasse Sept. 8 test. pp.840-843;

Ameren's auction proposal allows all of the above factors to work in AER's favor at the expense of consumers. AER is expected to be a direct bidder in the auction. Nelson Dir. test. pp. 39-47; Baxter Sept. 14 test. pp. 404-410. AER further admits that it is well positioned as a direct bidder because, with its lower cost generation, it has a competitive advantage over other bidders who have higher cost generation. Id. But the step down in prices during the auction ends when other bidders with higher costs and lower margins no longer bid any more power into the auction. This is true even though AER as a bidder could afford to bid an even lower price. Consequently, AER is excellently positioned to

obtain a high price for its generation through the auction. Moreover, the consumer loses out by having to pay higher auction prices caused by the higher cost, lower margin bidders.

Ameren contends that AER would be unwilling to bid or sell lower because it supposedly could get higher prices in the spot market. This position is not well taken. If that were truly the case, then the auction would be doomed from the start. No bidder would be interested in bidding if they believe they are better off selling all of their power into the spot market. But Rodney Frame, Ameren's own expert explained why any bidder would prefer to sell into the auction instead of on the spot market. He testified, "That there's a certain certainty of your revenue [stream] that a lot of investors would find comforting." Sept.14 test. at 377.

The auction process also is designed to avoid FERC disapproval of AER's winning bid.. As Warner Baxter explained, FERC is concerned when a company like Ameren pays higher than market rates to acquire electricity from its generating affiliates like AER. Baxter Dir. test. p.5. As Craig Nelson further explained FERC probably would not nullify AER's winning auction bid because it resulted from an auction process. Nelson Dir. Test. pp 43-48. Consequently, Ameren can use the auction process to justify AER's receiving high prices for its low-cost, high-margin electricity production.

K. Regulatory oversight and review.

The hearing testimony makes clear that the ICC should reject the proposals even assuming *arguendo* that it has the jurisdiction to act here. The auction proposals eliminate the Commission's obligation to perform an after-the-fact prudence review of the resulting auction prices. The proposals further eliminate the Commission's obligation to set or

approve just and reasonable rates. This removes the only meaningful protections for consumers and subjects them to the substantial risk of paying unreasonable and unjust rates, all of which is contrary to the Act.

After the auction closes, the auction manager, an Ameren hired agent, has only one business day to file her report concerning the auction. This report merely provides a factual summary of the activities and events that occurred during the course of the auction, the resulting prices and the manager's affirmation that the auction rules apparently were followed. Notably absent from the report or from any other source is an after-the-fact analysis whether the prices resulting from the auction are reflective of market prices. Baxter Sept 14 test. pp. 428-430.

Then, the Commission, with no analysis of whether the resulting rates are in fact reflective of market prices, has only three business days from the close of the auction to accept the results. It can reject the results only if there is unambiguous evidence that the auction process was not followed. Id & Nelson Dir. test. p. 24 & Sept. 13 test. pp 104-106.

Consequently, we are to accept on blind faith that the prices are fair simply because the auction rules have been followed. Id. & Blessing Sept 14 test. Indeed, Ameren feels so strongly about this assumption that it insists that the actual auction prices need not be subject to any after-the-fact prudence review of any sort or determination of their justness or reasonableness. Id.

Ameren's testimony, alone, raises serious doubts about such an assumption. In particular, James Blessing, Managing Supervisor, Power Supply Acquisition in the Strategic Initiatives Department testified as follows:

> Q. And in terms of the clearing price that's determined for the auction, are you expecting anyone from your company to do an independent analysis of those clearing prices to determine whether they seem to be fair competitive prices to pass on to the consumer? A. I'm not sure how that would be accomplished.

Blessing Sept. 14 test. p. 518. When Warner Baxter was asked the same question, he did not know and deferred to Dr. LaCasse for an answer. When Dr. LaCasse was asked the question, she responded as follows:

> Q. How are you going to know during the auction process actually what the results are are competitive market prices? A. Well, as I said, it's the confluence of these factors in the sense the if the bidding in the auction has been competitive, if the bidding patterns are what we would expect from a competitive auction, if there were no difficulties with the bidding procedure, if there is no external events that we believe has impacted the bidding and would have been transitory, given all these factors, if all these factors are in the affirmative, then I would believe that the resulting prices are competitive market prices.

LaCasse Sept. 8 test. pp. 847-848. In effect, her answer shows that we are to accept on blind faith alone that the mere following of the auction rules should result in competitive prices. But again, no one says that the auction clearing prices can be compared to actual electrical wholesale prices of any sort to judge whether they in fact are reflective of market prices or, more importantly, are just and reasonable.

There is a reason that no one can say whether the actual clearing prices are reflective of any market prices. Ameren has created an auction product that is not traded or has comparably priced equivalents. The absence of comparably priced products in the market leaves it virtually impossible to determine in real time or immediately thereafter whether the ending auction prices are in fact reasonable or competitive.

Does Ameren, however, share any risk that customers are not receiving "fair market pricing"? Obviously not, since it's proposing that its cost of power flows through directly to customers dollar for dollar. More importantly, however, customers paying anything

other than just and reasonable prices would be in violation of the Act and in derogation of the Commission's obligations to customers. Because of the nature of the "specialized products' being auctioned and the lack of comparably priced market products, only an after-the-fact, traditional ratemaking prudence review will detect whether the customer rates resulting from the auction prices are just and reasonable. Such a prudence review is precisely what Ameren wants to avoid

Ameren claims that any delay in approving the auction prices might drive prices up. But yet, Ameren hasn't offered one bit of quantitative analysis to support this supposition. Likewise, it did not elicit any similar quantitative testimony from a possible bidder. Mere conjecture should not cause the ICC to eliminate the only true protection consumers have to avoid paying unjust or unreasonable rates.

Ameren's true motivation, however, is that it dislikes after-the-fact prudence reviews. The reviews put it at risk of not being able to pass on all of its costs to consumers. Nelson Sept. 13 test. pp. 102-103

In sum, the ICC should not abdicate its responsibility to perform an after-the-fact prudence review based on mere conjecture, disputed auction methods and Ameren's distastes for prudence reviews. Customers should not lose their only true protection against paying unjust and unreasonable prices; a risk that the customers only bear because Ameren intends to recover every dollar it pays for the power from its customers.

Dr. Steinhurst hit the nail squarely on the head when he testified that after-the-fact prudence reviews are:

> The only sure safeguard that consumers who lack competitive retail alternatives have to be confident on an ongoing basis that their service is going to be a just and reasonable rate. I don't believe that that decision can be made by approving a particular process at one point in time and just letting the chips fall where they may.

> The protections developed for what are essentially captive retail customers over the years in the utility arena are balanced, fair, sound and appropriate, and they should not be blown away for such captive customers just because the utility is more comfortable without the responsibility." Steinhurst Sept. 7th Test. p 512.

VI. PROCUREMENT PROCESSES ALTERNATIVES

A. -E. Ameren should have presented the ICC with a full exploration of the range of options for procuring resources to serve default service customers, comparing them objectively in terms of their impact on the costs and risks. Steinhurst Reb. p.7 Such a proceeding could have allowed a reasoned determination of which approach would best satisfy the needs of ratepayers and other parties.

As Dr. Steinhurst explained, Ameren would have certain advantages if it managed its own portfolio, including experience, access to the best information about customers and their requirements, ongoing real time data collection, and potentially lower equity returns requirements and debt rates. Steinhurst Reb. test.pp.18-28. Diversified, actively managed procurement would allow flexibility in procurement decisions and negotiations. If properly managed and utilized, this flexibility can provide benefits that would not be possible under rigid auction rules. Id. The full range of opportunities and benefits to the supplier—including non-monetary benefits, such as a stable income stream, the value of a business relationship, or any aspect of the transaction that has value to the supplier and lead it to reduce the price vis-à-vis an alternative—must be considered for this comparison. Id.

As Dr. Steinhurst further testified, there are many products that Ameren can combine into an actively managed portfolio design. Id. For example, in terms of power and

energy, just a few of the products that should be evaluated to determine how their costs and risk profiles would affect default service rates include: standard wholesale electric power market forward contracts of various lengths from a month to a number of years and a wide range of starting dates; spot purchases; bilateral negotiated contracts of varied terms, sizes or start dates; unit-specific power contracts with owners of existing units; non-unit-specific power contracts with owners of groups of existing units; residual load following contracts; options to buy (or sell) power at various prices at various times; and at-cost, fixed price, turn-key or other types of arrangements for power from new or existing units at various locations. Id. In addition, non-power contract products that could be included in portfolios include weather and fuel price futures contracts or options. Id. A soundly designed and actively managed portfolio for the benefit of default service customers can be an improvement in risk, price, or both compared to Ameren's proposed one-product, one-day-a-year auction.

As the purchaser of power for default service customers, as Dr. Steinhurst further explained, Ameren would have significant bargaining power and could bring discipline to the wholesale markets. Id.. Choosing a diverse portfolio of resources, actively managed for the benefit of default service customers would allow Ameren to pick and choose among offers of different types, opt for short-term or open positions if markets do not produce reasonable results, or fall back on any or all of the many other product choices listed above, all in an infinite range of combinations driven by the actual offers available. Id.

Ameren, as a buyer, also could optimize its portfolio with a different objective (protecting customer interests and risk preferences) than suppliers that will optimize

based upon their own risk preferences. Id. For example, many consumers, especially small consumers with few opportunities to shop, value low risk resources. Increasing the variety of products and portfolio options being considered is one way to deliver this preferred outcome to those smallest consumers. Id. A diverse, actively managed portfolio can be readily adapted to cope with changes in markets, both supply and demand. Id. Ameren's proposed portfolio design and procurement method not only passes through to default service consumers all the costs and risks of that procurement, but actually exacerbates some of those risks by placing all of the default service load on single-product, single-date auctions. Id.

Ameren proposes to deprive default service customers of the benefits that could be obtained from a more diversified portfolio and procurement process, simply so it can avoid the responsibility for making portfolio design and management decisions, tasks that it once routinely performed and are routinely performed by its affiliates today (albeit not for the benefit of ratepayers), and by commodity managers for all sorts of businesses.

Ameren misrepresents both the breadth of procurement options open to it, as well as the considerable flexibility given to it under Illinois's restructuring legislation. Ameren continues to have all the flexibility it always did in choosing resources and procurement methods, plus additional, new flexibility in how it runs its business. Clearly prudent utilities have relied on a wide range of products, term lengths, and procurement methods to manage risk and cost. Few, if any, have had the temerity to place their entire resource portfolio in a "blind trust." Id. Given the magnitude of the costs and risks from uncompetitive wholesale markets, it is not appropriate for Ameren to simply give up on

protecting consumers from those costs and risks without seriously examining the alternatives.

Finally, as pointed out above, Ameren's true motives in favoring the auction over other procurement methods are to financially benefit itself and its affiliates, and to avoid the risks of after-the-fact prudence reviews and after-the-fact determinations of "just and reasonable" rates.

In the absence of pre-approval, Ameren is simply obligated to purchase electricity for customers and have rates set by the Commission as traditionally done for many years.

PROPOSED MODIFICATIONS IF THE AUCTION IS APPROVED

Prudence Review

If, however, the Commission is inclined to pre-approve the auction, then the ALJ's proposed order calling for annual prudence reviews should be adopted for the reasons stated above. CUB has one modification however. The rebuttable presumption of prudence should be eliminated. (Ex A. pp. 5-7)

As pointed out above, the Commission, with no analysis of whether the resulting rates are in fact reasonable, has only three business days from the close of the auction to accept the results. It can reject the results only if there is unambiguous evidence that the auction process was not followed. Additionally, as Ameren admits, under its proposals, the resulting auction prices alone are insufficient grounds to reject the auction even if they may seem too high given market conditions.

Moreover, the tranches created for the auction are unique and are not traded publicly. Consequently, there are no comparably priced products by which one can to determine the reasonableness of the auction clearing prices for the given products. The absence of

comparably priced products in the market leaves it virtually impossible to determine in real time or immediately thereafter whether the ending auction prices are based on prudently incurred costs or are "just and reasonable". Thus, since such issues remain open even after the approval of the auction, the auction prices should not carry with them any presumptions concerning their prudence, justness or reasonableness. Accordingly, CUB requests the Exceptions set out on pages five through 7 of Exhibit A.

Federal Preemption

If the Commission is inclined to pre-approve the auction, then the ALJ's proposed order on the issue of federal preemption was also correct. (Ex A. 8-9) Ameren cites *Nantahala Power & Light Co. v Thornburg,* 476U.S. 954 (1986) as not allowing the Commission to deem the paying of FERC approved wholesale rates as imprudent even if cheaper electricity is available for purchase. *Nantahala* does not hold this and does not even involve a public utility trying to have FERC approved wholesale rates deemed prudently incurred. To the contrary, federal courts have specifically ruled that state public utility commissions, such as the Commission, do have the power to deem a utility's payment of FERC approved rates imprudent and to disallow those FERC approved paid prices from being passed on to customers dollar for dollar through rates. *Kentucky West Virginia Gas Co. v Pennsylvania Public Utility Commission,* 837 F. 2d 600 (3rd Cir. 1988); See also *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission,* 465 A.2d 735 (Pa. 1983) The *Kentucky* gas case is particularly on point. The utility there could have purchased electricity from different sources at less than FERC wholesale prices and that is why the PPCC held that the utility acted imprudently in paying FERC approved wholesale prices to its affiliate.

Ameren is also wrong that the FERC would disapprove a contract with an affiliate at less than FERC approved wholesale prices. Ameren does not cite--and cannot cite-- any authority whatsoever in support of this assertion. Indeed, no FERC case has ever held that a utility cannot purchase electricity from an affiliate at below wholesale or market prices. In fact, many witnesses testified that FERC is only concerned about above market price affiliated contracts. Mr. McNeil, a ComEd employee, testified: " Q But I think you said in response to Allan's question that under your knowledge of what FERC does and what Edgar means, they would be more concerned if that bilateral contract had set a price higher than the market rather than lower than the market, isn't that correct? A I think that's one of their main concerns." McNeil Aug. 30 test. p 529. As Ms Juracek, another ComEd employee testified: "Q. Is it true that that Edgar standard was primarily designed to prevent an affiliate from charging more than market rates to its other affiliated company? A. Yes." Juracek Aug 29 test. p. 269. Moreover, the holdings in *Pike County* and *Kentucky West Virginia Gas Co* also confirm, by implication, that the FERC is not concerned about contract prices that are below market or FERC approved prices.

Consequently, if Ameren really wanted to purchase electricity from AER or Genco, or anyone else at less than wholesale prices, no law prevents it from doing so. Moreover, Ameren's own expert admitted that there are many benefits to a generator in entering into long-term bilateral contracts. Dr. Hogan Sept.1 test. p.1109. Long-term contracts create a stable revenue stream for generators and enhance their ability to favorable financing. Id. While such a contract or contracts would clearly benefit Ameren customers as well and fulfill Ameren's obligation to get the best prices for them, it wouldn't make Ameren Corp shareholders, including Ameren executives, very happy. They expect to profit

substantially from AER and Genco receiving the much higher clearing prices resulting from the auction.

D. Auction Management 4. Representation of Consumer Interests

The ALJ proposed order did not create a separate consumer advisor or a state created monitor. As Dr. Steinhurst testified, while the MMU monitors the market, its capabilities and authority are limited. Steinhurst Dir. Test. pp.40-47 These limitations prevent the monitor from assuring a fully competitive, working market. Moreover, while the FERC performs some additional monitoring and that the MMU and the FERC work together in some regards, this is insufficient in preventing the exercise of market power.

The Commission should require as a condition precedent to any competitive procurement process for Illinois that a state-level entity be established. This entity would reside within the Illinois Attorney General's Office and would be charged with representing electricity consumers' interests by monitoring the development and performance of wholesale electricity markets and associated markets for capacity, transmission and other goods and services. The IMMU's purpose would be to detect actual and potential market power and abuse and take action to prevent or eliminate such market power or abuse wherever it occurs.

The IMMU's potential remedies would include petitioning RTOs, the FERC, or the U.S. Department of Justice to take action. This state level entity also should have access to confidential market data and the authority beyond RTO-administered markets to conduct broader investigations of energy industries.

Further, consumers should have a separate auction observer whose sole purpose is to represent consumers. Steinhurst Dir. Test. pp. 34-40 As it stands now, all of the auction

managers or observers have a connection to Ameren or the Commission. These people have duties and obligations that may conflict with the interests of consumers. The appointment of a consumer observer eliminates the risks associated with such conflicts.

The Commission should hold that a Consumer Observer be appointed with the ability to recommend rejection of the auction results on the basis that the auction resulted in unreasonable price bids, because of market abnormalities or that the auction rules were not followed. The consumer observer should be selected by, and *only* by, the specific consumer advocacy entities that are identified as appropriate for that role in the design of the auction procurement. In particular, no other stakeholders should have any authority over that selection or over the actions of the consumer observer. The only exception to that provision should be the ability of the Company to request the Commission to enforce whatever agreements or orders covering the activities of the consumer observer, including but not limited to confidentiality agreements.

Accordingly, if the Commission approves the auction, CUB request the Exceptions set out on Exhibit A. pages 16-18.

Rider CPP--10. Customer Supply Group Migration Risk Factor

The ALJ proposed order does not include a migration risk factor. It is most likely that, when developing bidding strategies and prices, suppliers will consider the likelihood and level of possible customer switching. Without the explicit inclusion of a migration risk factor, residential customers, who are least likely to migrate, will bear the risk premium associated with the propensity that commercial and industrial customers have to migrate. Accordingly, if the auction is approved, the Commission should include a migration risk factor and adopt the one proposed by CES. (Ex. A p. 23)

X.CONCLUSION

For all of the above reasons, Ameren's proposals should be denied. Ameren should procure power as it deems appropriate but subject to the traditional rules of ratemaking. In other words, Ameren should acquire the power and then submit its conduct to the Commission for an after-the-fact prudence review, just as the Act requires. The Commission should also do an after-the-fact determination of the rates, assuring that they are "just and reasonable". Again, this is exactly what the Act requires. These after-the-fact reviews are designed to protect consumers and should not--and cannot-- be abandoned.

If, however, the Commission is inclined to pre-approve the auction, then CUB requests its Exceptions be adopted for the reasons stated above.

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